

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Application of Pennsylvania-American Water	:	A-2017-2606103
Company-Wastewater under Section 1329 of the	:	
Pennsylvania Public Utility Code, 66 Pa. C.S.	:	
§ 1329, for approval of the use for ratemaking	:	
purposes of the lesser of the fair market value or the	:	
negotiated purchase price of The Municipal	:	
Authority of the City of McKeesport's assets related	:	
to its wastewater collection and treatment system	:	
and other related transactions.	:	

RECOMMENDED DECISION

Before
Mark A. Hoyer
Deputy Chief Administrative Law Judge

Mary D. Long
Administrative Law Judge

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I. INTRODUCTION

In this application, which seeks approval from the Commission for the acquisition of a municipal wastewater system and approval of a ratemaking rate base, the parties have reached a full settlement of their dispute. The settlement permits the Pennsylvania-American Water Company to acquire substantially all of the assets of the Municipal Authority of the City of McKeesport and to establish a ratemaking rate base of \$158 million. It is recommended that the Commission approve the Settlement without modification.

II. HISTORY OF THE PROCEEDING

On May 24, 2017, Pennsylvania-American Water Company (Applicant or PAWC) filed an Application pursuant to Sections 1102 and 1329 of the Public Utility Code requesting, among other things, approval from the Pennsylvania Public Utility Commission to issue certificates of public convenience to PAWC for the transfer to PAWC, by sale, of substantially all of The Municipal Authority of the City of McKeesport's (MACM) assets, properties, and rights related to MACM's wastewater collection and treatment system (the System) and to set the fair market value of the acquisition for rate-base ratemaking purposes. PAWC also filed a request for the approval of the accompanying agreements for the transaction pursuant to Section 507 of the Public Utility Code. Following the receipt of additional information responsive to a data request by the Commission's Bureau of Technical Utility Services, the Commission accepted the filing of the Application as complete by Secretarial Letter dated June 14, 2017.

Notice of the filing was published in the *Pennsylvania Bulletin* on June 24, 2017. That notice established the deadline for filing protests and petitions to intervene as July 10, 2017.

The Commission's Bureau of Investigation and Enforcement (I&E) entered its appearance on June 21, 2017. The Office of Consumer Advocate (OCA) filed a protest on June 21, 2017. On June 28, 2017, the City of McKeesport (City) and MACM each filed a petition to intervene.

On June 23, 2017, Deputy Chief Administrative Law Judge Mark A. Hoyer issued a Prehearing Conference Order scheduling a prehearing conference for Thursday, July 13, 2017 at 10:00 a.m. The order also modified the Commission's procedures for formal discovery, and directed the parties to provide prehearing memoranda by July 12, 2017. On June 26, 2017, notice of the prehearing conference was mailed.¹

On June 26, 2017, PAWC filed a Petition for Protective Order, which was unopposed. The Petition for Protective Order was granted on July 13, 2017.

The prehearing conference was held as scheduled on July 13, 2017. PAWC, I&E, OCA, the City and MACM each filed a prehearing memorandum and were represented at the conference. The petitions to intervene of the City and MACM (hereafter, collectively MACM) were granted and the parties discussed and agreed upon a litigation schedule. A prehearing order issued on July 13, 2017, set forth a schedule for the service of written testimony and scheduled evidentiary hearings in Harrisburg on August 3-4, 2017.

The parties served written direct, rebuttal and surrebuttal testimony as directed by the July 13, 2017 Prehearing Order. The evidentiary hearing convened on August 3, 2017 as scheduled. Counsel for PAWC, David P. Zambito and Jonathan Nase; MACM, Thomas Wyatt; OCA, Christine M. Hoover and Erin Gannon; and I&E, Erika McClain and Gina L. Miller, appeared.

The parties stipulated to the entry of testimony and exhibits and waived cross examination of the following PAWC witnesses: Beatty W. Morgan, Jr., David R. Kaufmann; and James S. Merante. PAWC also presented the written and live testimony of Bernard J. Grundusky, Rod P. Nevirauskas, Michael Cherepko and Jerome C. Weinert. The written testimony and exhibits of these witnesses was admitted into the record.

¹ Administrative Law Judge Mary D. Long was also assigned to the case on June 28, 2017.

MACM presented the written and live testimony of Adrienne M. Vicari. Ms. Vicari's written testimony and accompanying exhibits were admitted into the record.

The parties stipulated to the entry of testimony and exhibits and waived cross examination of I&E's witnesses, Ethan H. Cline and Anthony Spadaccio.

OCA presented the written and live testimony of Ashley E. Everette and Glenn A. Watkins. The written testimony and exhibits of these witnesses was also admitted into the record.

The parties all filed main and reply briefs. On September 5, 2017, the parties informed us that they had achieved an agreement which would result in a full settlement of their dispute. A Joint Petition for Settlement (Joint Petition or Settlement) along with statements in support was filed on September 20, 2017.

III. STIPULATED FACTS OF THE PARTIES

Parties

1. PAWC, a subsidiary of American Water Works Company, Inc., is the largest investor-owned public utility in Pennsylvania. It provides water and wastewater service to the public in a service territory encompassing more than 400 communities in 36 counties. It serves a combined population of over 2,300,000. PAWC St. No. 1 p. 13-14.

2. As of December 31, 2016, PAWC furnished wastewater services to 54,691 customers in Pennsylvania and water services to 654,770 customers. PAWC St. No. 1 p. 15.

3. The City is a city of the third class under the Constitution and laws of the Commonwealth of Pennsylvania and the City's Home Rule Charter. Asset Purchase Agreement (APA) p. 1.

4. The City is located in Allegheny County. PAWC St. No. 6 p. 4. It had 19,731 residents in 2010. PAWC St. No. 6 p. 4.

5. MACM is a body corporate and politic, duly organized under the Pennsylvania Municipal Authorities Act. APA p. 1.

6. MACM is run by a board, independent of the City. Tr. 80.

7. I&E serves as the Commission's prosecutory bureau for the purposes of representing the public interest in ratemaking and service matters, and enforcing compliance with the Pennsylvania Public Utility Code, 66 Pa.C.S. §§ 101 et seq., and Commission regulations, 52 Pa.Code §§ 1.1 et seq. *See Implementation of Act 129 of 2008; Organization of Bureaus and Offices*, Docket No. M-2008-2071852 (Order entered August 11, 2011).

8. The I&E analysis in the proceeding is based on its responsibility to represent the public interest. This responsibility requires balancing the interest of ratepayers, the utility company, and the regulated community as a whole. I&E St. No. 1 p. 1; I&E St. No. 2 p. 1.

9. The OCA is a Commonwealth agency created by Act 161 of 1976 to represent the interests of consumers before the Pennsylvania Public Utility Commission. 71 P.S. § 309-2.

The System

10. MACM owns and operates a combined wastewater collection system and three wastewater treatment plants which collect and treat wastewater from the City, the City of Duquesne, the Borough of Dravosburg, the Borough of Port Vue and a portion of the Borough of West Mifflin, Allegheny County, Pennsylvania. PAWC St. No. 3 p. 3.

11. The System also provides wastewater service through bulk service connections to White Oak Borough, Lincoln Borough Liberty Borough, East McKeesport Borough, Glassport Borough, Versailles Borough, Elizabeth Township and the Municipal Authority of Westmoreland County. Application, Appendices B-2 through B-16.

12. The eight municipalities that have inter-municipal service agreements with MACM own and operate their own collection systems, which connect to the McKeesport interceptor system. PAWC St. No. 3 p. 3.

13. The collection systems in Duquesne and Dravosburg transport sewage from their respective communities to their own wastewater treatment plants, and are not interconnected to the other systems. PAWC St. No. 3 p. 3.

14. As of December 31, 2016, MACM furnished wastewater services directly to 12,780 customers. PAWC St. No. 1 p. 15. It provided service directly or indirectly to approximately 22,000 customers, because of the bulk service agreements with surrounding municipalities. PAWC St. No. 1-R p. 13.

15. The System is a combined system, which conveys domestic sewage and other wastewaters and stormwater in the same system of pipes. PAWC St. No. 2 p. 10.

16. There is no reasonable way to physically segregate the wastewater operations from the stormwater operations. PAWC St. No. 2 p. 12.

17. MACM accepts and treats bulk sewage from eight communities via direct or adjoining municipal sewer systems. Three of these interconnections are located slightly outside of the applied-for service territory, and PAWC has requested Commission approval to continue providing bulk service at these points of interconnection. PAWC St. No. 1 p. 19.

The Asset Purchase Agreement and the First Amendment to the Asset Purchase Agreement

18. The City and MACM have considered selling or leasing the System for years. PAWC St. No. 6 p. 6.
19. MACM purchased the Dravosburg and Duquesne wastewater systems in 2011. OCA St. 1 at 14-15.
20. On February 26, 2016, MACM issued a Request for Bids for either an APA of the MACM Wastewater Treatment Facilities or Concession Lease Agreement. PAWC St. No. 1 p. 8.
21. In April 2016, MACM purchased the Borough of Port Vue's wastewater system. I&E St. No. 1 p. 4.
22. PAWC has indicated that the Port Vue portion of the System was considered in both the negotiations for the APA and the appraisals completed by the utility valuation experts (UVEs). PAWC St. No. 1-R p. 9-11.
23. On July 29, 2016, PAWC submitted an Asset Purchase bid to acquire MACM's assets. PAWC St. No. 1 p. 8.
24. On September 9, 2016, MACM and PAWC entered into the APA for the sale of substantially all of the assets, properties and rights of the System to PAWC for the greater of: \$156,000,000 or the average of the two UVE's appraisals. PAWC St. No. 1 p. 11.
25. In September 2016, PAWC's UVE appraised the System as having a fair market value of \$157,600,000. Application, Attachment A-5 (correspondence dated May 17, 2007, p. 2).

26. HRG originally determined that the fair market value of the MACM system assets is \$207,010,000. HRG Appraisal p. 13.

27. When PAWC was advised that MACM's UVE had appraised the System as having a fair market value of \$207,010,000, PAWC, the City and MACM negotiated the First Amendment to the APA. PAWC St. No. 1 p. 11-12; PAWC St. No. 1-R p. 9.

28. On May 15, 2017, the City, MACM and PAWC entered into the First Amendment to the APA, which revised the purchase price of the System to be \$162,000,000. PAWC St. No. 1 p. 8.

29. Following the execution of the First Amendment to the APA, the UVEs were advised of the new purchase price, and were given an opportunity to adjust their appraisals in their independent discretion. PAWC St. No. 1 p. 12.

30. In May, 2017, PAWC's UVE subsequently re-appraised the System. At that time, he found that the System had a fair market value of \$161,343,000. Application, Attachment A-5 (correspondence dated May 17, 2017 p. 1).

31. MACM's UVE did not re-appraise the System following the negotiation of the First Amendment to the APA. During discovery, however, it was determined that MACM's UVE had understated the age of the collection system. Upon further review, MACM's UVE appraised the System as having a fair market value of \$190,840,000. MACM St. No. 1 p. 67.

32. MACM will receive a portion of the purchase price sufficient to pay off its debts, bonds and obligations that are not assigned to the City or PAWC. MACM will then be dissolved and terminated. PAWC St. No. 6 Exh. MEC-3.

33. The City will receive the balance of the purchase price under the APA. APA Section 3.02. The City indicates that it intends to use these funds to balance the budget,

invest in infrastructure improvements market the City and improve services to existing business and residents. PAWC St. No. 6 p. 9.

The Application and the UVEs' Appraisals

34. The Application was filed May 24, 2017. Application (Correspondence dated May 24, 2017).

35. On June 3, 2017, the Commission's Bureau of Technical Utility Services notified PAWC that it believed the Application did not contain certain information.

36. PAWC responded to TUS's "Deficiency Letter" on June 8, 2017. PAWC Response to Bureau of Technical Utility Service's Deficiency Letter (Correspondence dated June 8, 2017 p. 2).

37. The Commission acknowledged receipt of the complete Application on June 14, 2017. Secretarial Letter dated June 14, 2017.

38. Notice of the Application was published in the Pennsylvania Bulletin on June 24, 2017. 47 Pa.B. 3568.

39. PAWC's Application is seeking to utilize the process set forth in Section 1329 of the Public Utility Code, 66 Pa.C.S. § 1329, to determine the fair market value of the MACM system assets and the ratemaking rate base of those assets. PAWC St. No. 1 p. 4.

40. As required by Section 1329, the parties to the APA engaged an engineer (KLH Engineers) to conduct an assessment of the tangible assets of the System. PAWC St. No. 7 pp. 13, 16.

41. As required by Section 1329, the Application included the appraisals of PAWC's UVE and MACM's UVE. Application, Attachment A-5.

42. PAWC selected Associated Utility Services, Inc. ("AUS") to perform an appraisal of the MACM system. PAWC St. No. 1 p. 7.

43. AUS was approved by the Commission for placement on the Commission's Utility Valuation Expert ("UVE") Registry. PAWC St. No. 7 p. 7.

44. MACM selected Herbert, Rowland & Grubic, Inc. ("HRG") as its utility valuation expert, to perform an appraisal of the MACM system. MACM St. No. 1 p. 2. HRG was approved by the Commission for placement on the Commission's Utility UVE Registry. MACM St. No. 1 p. 2.

45. HRG included a "going value" of \$17.3 million in the cost approach and income approach in its Fair Market Valuation of MACM. Tr. 118; HRG Appraisal pp. 12-13.

46. AUS did not include a "going value" in its fair market valuation of the MACM System.

PAWC's Financial Fitness

47. No party to this proceeding challenged PAWC's financial fitness to own and operate the System.

48. PAWC had total assets of approximately \$4.35 billion as of December 31, 2016. PAWC had net income of approximately \$153 million for the 12 months ending December 31, 2016. PAWC St. No. 1 p. 18.

49. In 2015, PAWC had operating income of approximately \$307 million, net income of approximately \$143 million, and cash flows from operations of approximately \$308 million. PAWC St. No. 5 p. 4.

50. In addition to positive cash flows, PAWC may obtain financing from a line of credit, long term debt financing, and equity investments. PAWC St. No. 5 p. 4.

51. PAWC is a large, financially sound company that has the capability to finance necessary capital additions. Given its size, access to capital and recognized strengths in system planning, capital budgeting and construction management, PAWC is well-positioned financially to provide wastewater service meeting all federal and state requirements. PAWC St. No. 5 p. 3.

52. PAWC indicates that it will initially fund the Transaction with short-term debt and will later replace it with a combination of long-term debt and equity capital. PAWC St. No. 5 p. 5.

53. PAWC carries a corporate credit rating of “A3” from Moody’s Investors Services and an “A” rating from Standard and Poor’s Rating Services. PAWC St. No. 5, p. 4.

PAWC’s Technical Fitness

54. No party to this proceeding challenged PAWC’s technical fitness to own and operate the System.

55. PAWC currently operates 16 wastewater treatment plants in Pennsylvania. PAWC St. No. 2 p. 4; PAWC St. No. 3 p. 27.

56. PAWC employs approximately 1,000 professionals with expertise in all areas of water and wastewater utility operations. PAWC St. No. 1 p. 14.

57. PAWC indicates that, as a subsidiary of American Water, it has available to it, the resources of American Water Works Service Company, Inc., which provides access to highly-trained professionals with expertise in specialized areas. When operational issues arise at facilities owned by PAWC, the company states that it mobilizes engineering talent from its central engineering team, drawing on resources from the Service Company, to identify potential problems, recommend options, and develop action plans. PAWC St. No. 2 p. 5.

58. PAWC has an ongoing program of capital investment focused on systematically replacing and adding new pipes and other infrastructure. PAWC St. No. 3 p. 18. PAWC has funded more than \$1 billion in infrastructure investment in the past five years. PAWC St. No. 3-R p. 7.

59. PAWC states that it has experience working through transitions, and has already implemented a plan to integrate MACM employees, customers, and the MACM system into PAWC's operations. PAWC St. No. 2 p. 10.

60. PAWC has extensive experience in the operation of wastewater collection and treatment systems. PAWC St. No. 1 p. 15-16.

61. PAWC has the expertise to provide safe and reliable sewer services to the customers of MACM and surrounding areas. PAWC St. No. 1 p. 14.

PAWC's Legal Fitness

62. No party to this proceeding challenged PAWC's legal fitness to own and operate the System.

63. PAWC is a Commission-regulated public utility with a good compliance history. PAWC St. No. 1 p. 17.

64. There are currently no pending legal proceedings challenging PAWC's ability to provide service to customers of the System. PAWC St. No. 1 p. 17.

65. PAWC has the expertise, the record of environmental compliance, the commitment to invest in necessary capital improvements and resources, and experienced managerial and operating personnel necessary to provide safe and reliable sewer services to the customers of MACM and the surrounding area. PAWC St. No. 1 p. 14, 15.

Benefits of the Transaction

66. After Closing, the System will be operated as a standalone system, supported by PAWC's surrounding water and wastewater system operations, as well as PAWC's statewide operations and American Water's nationwide resources. PAWC St. No. 2 pp. 7-8.

67. PAWC owns and operates water and wastewater facilities near McKeesport in the Pittsburgh Area and Southwestern Pennsylvania. PAWC St. No. 2 p. 6-7. The System is located adjacent to PAWC's MonValley/Elizabeth and Pittsburgh operations. PAWC provides water service to MACM's Dravosburg Borough customers. PAWC St. No. 2 p. 7. MACM's McKeesport and Port Vue customers are provided water service by the Municipal Authority of Westmoreland County and Duquesne is provided water service by the City of Duquesne Water Department. PAWC App. A-21.

68. PAWC has experience with the types of treatment technologies employed in the System, which involve activated sludge and SBR units similar to existing PAWC plants. PAWC St. No. 2 p. 4-5.

69. PAWC has experience operating a combined sewer over flow system (CSO) – the Scranton wastewater system. PAWC also has experience operating a system that has substantial wet weather challenges due to high rates of infiltration and inflow. PAWC St. No. 2 pp. 11, 26.

70. PAWC's range of engineering and operational experience, and its financial resources make it equipped to address the needs of the MACM system. PAWC St. No. 3 p. 16.

71. PAWC has a credit rating of "A3" from Moody's Investors Services and an "A" rating from Standard and Poor's Rating Services and has access to long term debt financing through its parent company at favorable interest rates and payment terms. When applicable, PAWC also uses low-cost financing through the Pennsylvania Infrastructure Investment Authority ("PENNVEST") and the Pennsylvania Economic Development Financing Authority ("PEDFA"). PAWC St. No. 5 p. 4.

72. The Transaction involves no duplication of services, so there is no adverse impact on PAWC's existing efficiency. PAWC St. No. 2 p. 8.

73. PAWC does not anticipate that the acquisition of the MACM System will have a negative impact on PAWC's cash flows, credit ratings or access to capital and, therefore, will not harm PAWC's financial status. PAWC St. No. 5 p. 3.

74. PAWC has committed to offer employment to the forty-six existing MACM employees, if eligible, following closing. PAWC St. No. 1 p. 13; PAWC St. No. 2 p. 15.

75. MACM's rates increased on January 1, 2017. Tr. 44.

76. Mayor Cherepko indicated that if the Commission would disapprove the Transaction, the City's already difficult financial situation will get worse. Tr. 81.

77. Current customers of MACM are not protected by the Pennsylvania Public Utility Code, the Public Utility Commission, the Bureau of Investigation and Enforcement, the Office of Small Business Advocate and the Office of Consumer Advocate. MACM operates

under a different regulatory framework. As a result of the Transaction, MACM's customers will receive those protections. PAWC St. No. 2 p. 23.

78. Rates for PAWC's existing customers will not increase in the short term due to the Transaction because the MACM system has not been included in PAWC's current base rate proceeding. PAWC St. No. 4 p. 8-9; PAWC St. No. 1-R p. 6.

79. Based on the estimated total cost of the MACM System under PAWC ownership, the initial rates for existing MACM customers will need to be increased in base rate case(s) following the end of the rate freeze for those customers to pay rates that cover more of their system's cost of service. OCA St. 1 p. 11, 13-14; OCA St. 1-S p. 2.

80. The Transaction would add 12,780 direct customers to PAWC's existing wastewater customer base of 54,691. PAWC St. No. 1-R p. 13; PAWC St. No. 1 p. 15; and PAWC St. No. 2 p. 6-7.

81. The goal of a cost of service study is to determine a utility's revenue requirement to provide service to its different customer classes. I&E St. No. 2 p. 21.

82. A cost of service study can establish the existence and extent of subsidization and assist in determining the appropriate amount of revenue requirement to be shifted from the wastewater customers to water customers. I&E St. No. 2 p. 21.

83. The need for a cost of service study should be assessed on a case-by-case basis. I&E St. No. 2-SR p. 16.

84. In *Joint Application of Pennsylvania-American Water Company and the Sewer Authority of the City of Scranton*, Docket No. A-2016-2537209 (Order entered October 19, 2016) p. 86, the Commission stated "As with all rate design issues, the basis of rate setting is a cost of service study. The absence of a study designed with specific direction to address

recovery of stormwater costs as a separate class would be an impediment to the full development of this issue in PAWC's next base rate proceeding."

Ratemaking Rate Base

85. The Parties have agreed to a ratemaking rate base of \$158,000,000. PAWC, the City and MACM will amend the APA to include a purchase price of \$159,000,000. PAWC St. No. 4 p. 3.

86. AUS's appraisal was prepared in compliance with USPAP. PAWC St. No. 7 p. 13.

87. In compliance with Section 1329, AUS's appraisal used three approaches to value the System: cost, market and income approaches. PAWC St. No. 7 p. 14.

88. HRG's appraisal was prepared in compliance with the USPAP. MACM St. No. 1 p. 9.

89. In compliance with Section 1329, HRG's appraisal used three approaches to value the System: cost, market and income approaches. MACM St. No. 1 p. 6.

Rate Stabilization Plan

90. Upon closing, PAWC will charge MACM's current rates as its base rates within the service territory, and such base rates will not be increased until after the first anniversary of the closing date of the Transaction. APA Section 7.05(b).

91. In light of PAWC's rate case filing history (approximately every three to four years), and under the provisions of the proposed Settlement, it is highly unlikely that rates for McKeesport area customers will be held constant pursuant to the APA for any period after

the first base rate case in which MACM assets are included. The first base rate case in which the System could be included is likely to occur in 2020 or later. PAWC St. No. 4 p. 7.

92. Under the APA, PAWC has committed to maintaining MACM's current base rates until after the one year anniversary of the closing date of the Transaction. 66 Pa.C.S. § 1329(g); PAWC St. No. 4 pp. 6-7.

DSIC, AFUDC, Deferred Depreciation, and Transaction and Closing Costs

93. Pursuant to Section 1329, PAWC seeks permission to collect a Distribution System Improvement Charge (DSIC) for the McKeesport service area. PAWC St. No. 1 p. 4.

94. An amended wastewater Long Term Infrastructure Improvement Plan (LTIIIP) must be filed and approved by the Commission before a DSIC can be implemented for the McKeesport service territory. PAWC St. No. 4-R p. 14.

95. PAWC's DSIC for McKeesport (as amended to include McKeesport) would be governed by its existing DSIC tariff and all of the stated customer safeguards would be applicable. PAWC St. No. 4-R p. 15.

96. PAWC's existing DSIC tariff was approved in Docket Nos. P-2014-2431005, et al. It is part of PAWC's Commission-approved tariff and therefore has the force and effect of law. PAWC St. No. 4-R p. 16.

97. In conjunction with the LTIIIP filing, PAWC will request permission to amend its existing DSIC tariff to include Rate Zone 13. Upon Commission approval of the LTIIIP amendment, PAWC will make a tariff supplement compliance filing to include Rate Zone 13 (McKeesport Area) as part of the existing DSIC tariff. PAWC St. No. 4-R p. 15.

98. PAWC will make improvements to the System after closing. PAWC St. No. 3 pp. 11-14. Some of these improvements will not be eligible for inclusion in PAWC's DSIC. PAWC St. No. 4 p. 10.

99. PAWC seeks permission for the accrual of an allowance for funds used during construction (AFUDC) for post-acquisition improvements not recovered through its DSIC for book and ratemaking purposes. PAWC St. No. 4 p. 9-10. The OCA and I&E reserve their rights to challenge the request in future rate cases.

100. PAWC is requesting to defer depreciation related to post-acquisition improvements not recovered through the DSIC for book and ratemaking purposes. PAWC St. No. 4 p. 10. The OCA and I&E reserve their rights to challenge the request in future rate cases.

101. PAWC has incurred transaction and closing costs associated with the acquisition of the System. PAWC St. No. 4-R pp. 12-13. The OCA and I&E reserve their rights to challenge these costs in future rate cases.

Rates

102. As required by Section 1329, PAWC included a *pro forma* tariff supplement in its Application. Application, Appendix A-13.

103. During discovery, PAWC revised the *pro forma* tariff supplement to reflect a rate that is established in MACM's existing bulk service agreements with municipalities. PAWC St. No. 4-R, Exhibit RPN-1.

104. Under the *pro forma* tariff (as revised), MACM's customers will be governed by rates for new PAWC Rate Zone 13. After PAWC closes on the Transaction, system customers will be subject to PAWC's prevailing wastewater tariff with respect to all rates other than the customer charge and consumption charge, including capacity reservation fees,

reconnection fees and the like, as well as non-rate related terms and conditions of service.
PAWC St. No. 4 p. 4.

105. System customers will continue to be billed monthly after closing, except that Port Vue Borough customers will continue to be billed quarterly. PAWC St. No. 4 p. 4.

106. Industrial Pretreatment Program (McKeesport) provisions in the *pro forma* tariff supplement would require industrial users discharging to the MACM system to comply with the industrial pretreatment program and establish fees. PAWC St. No. 3 p. 20.

Municipal Agreements

107. MACM currently has two agreements each, with eight municipalities, which PAWC would assume as part of the Transaction, in order to provide bulk service to surrounding communities following closing. PAWC St. No. 1 p. 20.

108. Approval of these contracts is reasonable and serves an important public purpose because the bulk services provided under the contracts are essential to the provision of wastewater service in neighboring communities. PAWC St. No. 1 p. 20.

I. DESCRIPTION OF THE SETTLEMENT

The Joint Petition includes the terms and conditions of the Settlement relating to the agreed upon fair market value for ratemaking purposes, the rate treatment of the acquired system, low income outreach, DSIC, accrual of allowance for funds used during construction, other rate-related issues and the agreements necessary to effectuate the Transaction. The Joint Petition includes Appendices A-H:

Appendix A	<i>Pro Forma</i> Tariff
Appendix B	Proposed Findings of Fact
Appendix C	Proposed Conclusions of Law

Appendix D	Proposed Ordering Paragraphs
Appendix E	Statement in Support of PAWC
Appendix F	Statement in Support of MACM
Appendix G	Statement in Support of I&E
Appendix H	Statement in Support of OCA

II. TERMS OF THE SETTLEMENT

The terms of the proposed settlement are set forth below. The original paragraph numbering has been retained for ease of reference for the reader. The settlement petition also includes the usual “additional terms and conditions” that are typically included in settlements. These terms, which, among other things, protect the parties’ rights to file exceptions if any part of the Settlement is modified, condition the agreement upon approval by the Commission and provide that no party is bound in future cases by any position taken in this Settlement. The Joint Petitioners also agreed to waive exceptions if the Settlement is approved without modification.² These additional terms and conditions will not be repeated here verbatim.

The Joint Petitioners agree as follows:

A. Approval of Application

12. The Application shall, subject to the other terms and conditions contained in the Settlement, be approved as being in the public interest and the Commission shall issue such Certificates of Public Convenience as may be necessary to evidence its approval pursuant to 66 Pa. C.S. §§ 1102(a) of (i) the transfer, by sale, of substantially all of MACM’s assets, properties and rights related to its wastewater collection and treatment system to PAWC, and (ii) PAWC’s right to begin to offer, render, furnish and supply wastewater service in the areas served by MACM in the City of McKeesport, the City of Duquesne, Port Vue Borough, the Borough of Dravosburg, and a portion of West Mifflin Borough, Allegheny County, Pennsylvania and to three bulk service interconnection

² Joint Petition, ¶ 35.

points located in Liberty Borough, White Oak Borough, and North Versailles Borough, Allegheny County, Pennsylvania.

B. Tariff

13. The pro forma tariff supplement attached hereto as Appendix A, including all rates, rules and regulations regarding conditions of PAWC's wastewater service, shall be permitted to become effective immediately upon closing of the Transaction.

C. Fair Market Value for Ratemaking Rate Base Purposes

14. PAWC shall be permitted to use \$158,000,000 for ratemaking rate base purposes for the acquired assets. Commission approval of the Transaction shall be conditioned upon PAWC's filing of a further amendment to the Asset Purchase Agreement, along with copies of required authorizations from PAWC's Board of Directors, the City's Council, and MACM's Board of Directors, that (a) adjusts the purchase price to \$159,000,000 and (b) modifies Paragraph F of the First Amendment to the Asset Purchase Agreement (regarding PAWC's obligation in the first base rate case following closing of the Transaction to propose rates that, if adopted by the Commission, would ensure that McKeesport-system customers benefit from 66 Pa. C.S. § 1311(c) in the same manner as PAWC's other customers) such that PAWC will seek to utilize 66 Pa. C.S. § 1311(c) for the benefit of McKeesport system customers so long as such use is not inconsistent with PAWC's obligations under the Settlement.

15. Although the Joint Petitioners reserve the right to present adjustments and oppose adjustments to appraisals in future cases, for purposes of this proceeding, the Joint Petitioners request that the Commission accept the following adjustments:

(a) Market Approach: The purchase price for each acquisition shall be based on the actual amount paid for the assets at the time of purchase and future capital improvements shall not be included;

(b) Income Approach: The rate base / rate of return methodology is not an appropriate analysis for the appraisal;

(c) The "Going Value" and "Provision for Erosion on Return" add-ons will not be adopted or included in the appraisals; and,

(d) The overhead cost add-on will not be adopted or included in the appraisals.

D. Rates

16. Except as explicitly stated herein, nothing contained in the Settlement, or in the Commission's approval of the Application, shall preclude any Joint Petitioner from asserting any position or raising any issue in a future PAWC base rate proceeding or in any future PAWC acquisition proceeding.

17. At the time of filing its next base rate case, PAWC shall submit a cost of service study that fully separates the costs of providing the stormwater component of wastewater services in the McKeesport service area.

18. At the time of filing its next base rate case, PAWC shall submit a cost of service study that removes all costs and revenues associated with the operations (both the sanitary component and stormwater component of the wastewater service) of the MACM system and, using the same rate design methodology it proposes to be adopted in that case, develop rates in its next base rate case that exclude the impact of the System acquisition.

19. The plant in service costs of the Port Vue Borough component of the System shall be identified separately in the required cost of service studies. PAWC shall separately identify the plant-in-service costs at the time that the Port Vue system was purchased, the cost of any Port Vue plant retirements, and the cost of any Port Vue plant investment.

20. In its first base rate case following the closing of the acquisition, PAWC will propose to establish a rate zone for McKeesport and increase the rates of the System to an amount equal to the Zone 1 wastewater rates of PAWC's wastewater division, unless such increase would be more than two times the system-average increase for the wastewater division (calculated on a percentage increase basis). If the increase for the System would be more than two times the system-average increase of the wastewater division, PAWC will propose that the increase for the System be capped at two times the system-average wastewater division increase in this first base rate case. PAWC, the City and the OCA agree that they will not challenge or oppose this proposal in the first base rate case; provided, however, that the Joint Petitioners expressly recognize the Commission's ultimate ratemaking authority to set just and reasonable rates and, notwithstanding anything to the contrary contained in this paragraph, may enter into a settlement of the base rate case, whether

full or partial and whether unanimous or non-unanimous, on reasonable terms and conditions.

21. Notwithstanding anything to the contrary contained in this paragraph, the inclusion or exclusion of separate rates for the stormwater component of wastewater service shall, for purposes of determining whether the rate cap of Paragraph 20 of this Settlement has been reached, be dictated by the Commission's final resolution and any appeals of the issue of setting separate rates for the stormwater component of wastewater service in PAWC's currently-pending base rate proceeding at Docket No. R-2017-2595853 -- whether through approval of a settlement or through adjudication of the issue on a contested basis. PAWC may propose the use of 66 Pa. C.S. § 1311(c) with respect to any costs that would result in System rates in excess of the cap of two times the system average increase for the wastewater division. The OCA and I&E reserve the right to challenge such proposal, including any proposal to use Section 1311(c) to shift stormwater costs.

22. In its second base rate case following the closing of the acquisition, PAWC will propose to increase the rates of the System to an amount at least equal to the Zone 1 wastewater rates of PAWC's wastewater division. If such rates are less than the cost of service for the System (as determined pursuant to the cost of study performed in conjunction with such base rate filing), PAWC agrees to propose to further move the McKeesport rates towards the system's cost of service in this second base rate case. The OCA, I&E and the City reserve their rights to fully address this proposal in the base rate case and to make other rate proposals in the base rate case. The Joint Petitioners expressly recognize the Commission's ultimate ratemaking authority to set just and reasonable rates and, notwithstanding anything to the contrary contained in this paragraph, may enter into a settlement of the base rate case, whether full or partial and whether unanimous or non-unanimous, on reasonable terms and conditions.

E. Low Income Program Outreach

23. Within the first 90 days of PAWC's ownership of the System, PAWC shall include a bill insert to McKeesport-area customers regarding its low income programs or alternatively shall include such information in a welcome letter to McKeesport-area customers. The bill insert or welcome letter shall include, at a minimum, a description of the available low income programs, the eligibility requirements for participation in the programs, and PAWC's contact information. PAWC also agrees to ongoing,

targeted outreach to its McKeesport-area customers regarding its low income program. The Joint Petitioners shall confer in good faith and agree upon such additional outreach prior to closing of the Transaction.

F. Distribution System Improvement Charge

24. Pursuant to 66 Pa. C.S. § 1329, PAWC shall be permitted to collect a distribution system improvement charge (“DSIC”) prior to the first base rate case in which the McKeesport service area plant-in-service is incorporated into rate base; provided, however, that such permission shall be conditioned upon (i) PAWC’s filing of an amended wastewater long term infrastructure improvement plan (“Amended LTIIIP”) which does not re-prioritize other existing commitments in other services areas, (ii) the Commission’s approval of the Amended LTIIIP, as may be modified in the discretion of the Commission, and (iii) PAWC’s filing of a compliance tariff supplement which incorporates the McKeesport area rate zone into its existing DSIC tariff, including all customer safeguards applicable thereto, after Commission approval of the Amended LTIIIP.

G. Accrual of Allowance for Funds Used During Construction

25. The Joint Petitioners acknowledge that the Application includes a request that PAWC be permitted to accrue allowance for funds used during construction (“AFUDC”) for post-acquisition improvements not recovered through the DSIC for book and ratemaking purposes. The Joint Petitioners agree that they will not contest this request in this proceeding, but they reserve their rights to litigate their positions fully in future rate cases when this issue is ripe for review. The Joint Petitioners’ assent to this term should not be construed to operate as their preapproval of PAWC’s request.

H. Deferral of Depreciation for Post-Acquisition Improvements

26. The Joint Petitioners acknowledge that the Application includes a request that PAWC be permitted to defer depreciation related to post-acquisition improvements not recovered through the DSIC for book and ratemaking purposes. The Joint Petitioners agree that they will not contest this request in this proceeding, but they reserve their rights to litigate their positions fully in future rate cases when this issue is ripe for review. The Joint Petitioners’ assent to this term should not be construed to operate as their preapproval of PAWC’s request.

I. Transaction and Closing Costs

27. The Joint Petitioners acknowledge that the Application includes a request that PAWC be permitted to claim transaction and closing costs associated with the Transaction. The Joint Petitioners agree that they will not contest this request in this proceeding, but they reserve their rights to litigate their positions fully in future rate cases when this issue is ripe for review. The Joint Petitioners' assent to this term should not be construed to operate as their preapproval of PAWC's request.

J. Approval of Section 507 Agreements

28. Pursuant to 66 Pa. C.S. § 507, the Commission shall issue Certificates of Filing or approvals for the following agreements between PAWC and a municipal corporation:

a. Asset Purchase Agreement By and Among the City of McKeesport, The Municipal Authority of the City of McKeesport, as Seller, and Pennsylvania-American Water Company, as Buyer, Dated as of September 9, 2016, as amended by First Amendment to the Asset Purchase Agreement, Dated as of May 15, 2017, along with related City of McKeesport General Obligation Note, Series of 2016, No. R-1, related Intercept Agreement, Dated November 30, 2016, and related Second Deposit Agreement, which is yet to be executed, and as further amended by the amendment specified in Paragraph 14 of the Settlement;

b. Service Agreement By and Among The Municipal Authority of the City of McKeesport and Liberty Borough, Dated as of July 28, 2010;

c. Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and Liberty Borough, Dated as of July 28, 2008;

d. Service Agreement By and Among The Municipal Authority of the City of McKeesport and Lincoln Borough, Dated as of September 15, 2009;

e. Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and Lincoln Borough, Dated as of September 15, 2009;

- f. Service Agreement By and Among The Municipal Authority of the City of McKeesport and Elizabeth Township, Dated as of October 14, 2008;
- g. Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and Elizabeth Township, Dated as of October 14, 2008;
- h. Service Agreement By and Among The Municipal Authority of the City of McKeesport and The Municipal Authority of Westmoreland County for White Oak Borough, Dated as of August 2009;
- i. Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and The Municipal Authority of Westmoreland County for White Oak Borough, Dated as of August 2009;
- j. Service Agreement By and Among The Municipal Authority of the City of McKeesport, North Versailles Township, and The North Versailles Township Sanitary Authority, Dated as of October 1, 2008;
- k. Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport, North Versailles Township, and The North Versailles Township Sanitary Authority, Dated as of August 21, 2008;
- l. Service Agreement By and Among The Municipal Authority of the City of McKeesport and East McKeesport Borough, Dated as of September 11, 2008;
- m. Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and East McKeesport Borough, Dated as of August 2008;
- n. Service Agreement By and Among The Municipal Authority of the City of McKeesport and Versailles Borough, Dated as of October 22, 2008;
- o. Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and Versailles Borough, Dated as of October 22, 2008;

p. Service Agreement By and Among The Municipal Authority of the City of McKeesport and Glassport Borough, Dated as of August 19, 2008; and,

q. Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and Glassport Borough, Dated as of August 19, 2008.

K. Other Necessary Approvals

29. The Commission shall issue any other approvals or certificates appropriate, customary, or necessary under the Code to carry out the Transaction contemplated in the Application in a lawful manner.

III. LEGAL STANDARDS

In this case, the Applicant requests approval of: (1) the acquisition, by PAWC, of the wastewater system assets of MACM; and (2) an order approving the acquisition that includes the ratemaking rate base of the MACM wastewater system assets pursuant to Section 1329(c)(2) of the Code.³ Accordingly, PAWC has the burden of proof.⁴

The acquisition of MACM by PAWC requires the approval of the Commission as evidenced by its issuance of a certificate of public convenience.⁵ Before the Commission may issue a certificate of public convenience it must find that the granting of such certificate is necessary or proper for the service, accommodation, convenience, or safety of the public.⁶ That is, PAWC must demonstrate that the proposed acquisition will “affirmatively promote the ‘service, accommodation, convenience, or safety of the public’ in some substantial way.”⁷ To determine that the acquisition or merger is in the public interest

³ 66 Pa.C.S. § 1329(c)(2).

⁴ 66 Pa.C.S. § 332.

⁵ 66 Pa.C.S. §1102(a)(3).

⁶ 66 Pa.C.S. §1103(a).

⁷ *City of York v. Pa. Pub. Util. Comm’n*, 295 A.2d 825, 828 (Pa. 1972).

the Commission is not required to secure legally binding commitments or to quantify benefits where this may be impractical, burdensome, or impossible; rather, the PUC properly applies a preponderance of the evidence standard to make factually-based determinations (including predictive ones informed by expert judgment) concerning certification matters.⁸

Even where the Commission finds sufficient public benefit to find that the granting of a certificate of public convenience is necessary or proper for the service, accommodation, convenience, or safety of the public without imposing any conditions, the Commission nevertheless has discretion to impose conditions which it deems to be just and reasonable.⁹ In an acquisition context, when the Commission considers the public interest it is contemplated that the benefits and detriments of the acquisition will be measured as they impact on all affected parties and not merely on one particular group or geographic subdivision.¹⁰

Additionally, pursuant to Section 1103 of the Code, PAWC must show that it is technically, legally, and financially fit to own and operate the assets it will acquire from MACM.¹¹ As a certificated public utility, there is a rebuttable presumption that PAWC possesses the requisite fitness.¹²

Section 1329¹³ sets forth a procedure which permits a public utility to utilize fair market valuation for ratemaking purposes instead of the original cost of construction of the acquired facilities minus the accumulated depreciation. Section 1329 of the Code addresses the valuation of the assets of municipally or authority-owned water and wastewater systems that are acquired by investor-owned water and wastewater utilities or entities. The acquiring utility is

⁸ *Popowsky v. Pa. Pub. Util. Comm'n*, 937 A.2d 1040, 1057 (Pa. 2007) (Popowsky).

⁹ 66 Pa.C.S. §1103(a).

¹⁰ *Middletown Twp. v. Pa. Pub. Util. Comm'n*, 482 A.2d 674 (Pa.Cmwlt. 1984).

¹¹ *Seaboard Tank Lines v. Pa. Pub. Util. Comm'n*, 502 A. 2d 762, 764 (Pa.Cmwlt. 1985); *Warminster Twp. Mun. Auth. v. Pa. Pub. Util. Comm'n*, 138 A.2d 240, 243 (Pa.Super. 1958).

¹² *South Hills Movers, Inc. v. Pa. Pub. Util. Comm'n*, 601 A.2d 1308, 1310 (Pa.Cmwlt. 1992).

¹³ 66 Pa.C.S. § 1329.

authorized to collect a distribution system improvement charge. Section 1329 also enables a public utility or other acquiring entity's post-acquisition improvement costs not recovered through a distribution system improvement charge to be deferred for book and ratemaking purposes. In sum, Section 1329 helps mitigate the risk that a utility will not be able to fully recover its investment when water or wastewater assets are acquired from a municipality or authority.

If the parties agree to the Section 1329 process, an "acquiring public utility" and the seller of the municipal system each select a utility valuation expert (UVE) from a list of such experts established and maintained by the Commission. The selected UVEs perform independent appraisals of the system to establish its fair market value. Also, the acquiring public utility and the seller select one licensed engineer to conduct an assessment of the tangible assets of the seller which is incorporated into the valuations of the UVEs.

After receiving the valuations, the acquiring public utility must apply for a certificate of public convenience under Section 1102 of the Code and include the following as an attachment to the Section 1102 application: copies of the UVE appraisals; the agreed purchase price; the ratemaking rate base; the transaction and closing costs incurred by the acquiring public utility that will be included in its rate base; and a tariff containing a rate equal to the existing rates of the selling utility at the time of the acquisition and a rate stabilization plan, if applicable. 66 Pa.C.S. § 1329(d)(1). For applications involving an acquiring public entity under Section 1329(d)(1), the Commission has a six-month deadline for issuing a determination.

PAWC also seeks approval of an asset purchase agreement (APA) and other connected agreements pursuant to Section 507 of the Public Utility Code.¹⁴ Section 507 requires that contracts between a public utility and a municipal corporation (except for contracts to furnish service at regular tariff rates) be filed with the Commission at least 30 days before the effective date of the contract. The Commission approves the contract by issuing a certificate of filing, unless it decides to institute proceedings to determine whether there are any issues with

¹⁴ 66 Pa.C.S. § 507.

the reasonableness, legality, or any other matter affecting the validity of the contract. Should the Commission initiate proceedings, the contract or agreement is not effective until the Commission grants its approval. Section 507 is a filing requirement and does not require service of the filing on any potentially interested parties.

The Commission encourages parties in contested on-the-record proceedings to settle cases.¹⁵ Settlements eliminate the time, effort and expense of litigating a matter to its ultimate conclusion, which may entail review of the Commission's decision by the appellate courts of Pennsylvania. Such savings benefit not only the individual parties, but also the Commission and all ratepayers of a utility, who otherwise may have to bear the financial burden such litigation necessarily entails.

By definition, a "settlement" reflects a compromise of the positions that the parties of interest have held, which arguably fosters and promotes the public interest. When active parties in a proceeding reach a settlement, the principal issue for Commission consideration is whether the agreement reached suits the public interest.¹⁶

IV. DISCUSSION OF THE SETTLEMENT

In their supporting statements, the Joint Petitioners conclude, after extensive discovery and discussion, that this Settlement resolves most of the contested issues in this case, fairly balances the interests of the company and its ratepayers, is in the public interest, and is consistent with the requirements of the Public Utility Code.

After a full consideration of the terms of the Settlement and the statements in support, we recommend that the Commission adopt the proposed Settlement without modification.

¹⁵ See 52 Pa.Code § 5.231.

¹⁶ *Pa. Pub. Util. Comm'n v. CS Water and Sewer Associates*, 74 Pa. PUC 767, 771 (1991). See also *Pa. Pub. Util. Comm'n v. York Water Co.*, Docket No. R-00049165 (Order entered October 4, 2004); *Pa. Pub. Util. Comm'n v. Philadelphia Electric Company*, 60 Pa. PUC 1 (1985).

Not every issue was of equal concern to every party. Accordingly, each of the Joint Petitioners' statements in support did not address each and every aspect of the Settlement.

A. Section 1103 Approvals

1. Fitness

Even before the Joint Petitioners reached an accord on this application, no party disputed PAWC's technical, legal and financial fitness to render wastewater service. Indeed, as a certificated public utility, it enjoys a presumption of fitness.¹⁷ The stipulated facts support this conclusion.

PAWC is the Commonwealth's largest water and wastewater provider. It furnishes service to more than 400 communities in 36 counties, serving a combined population in excess of 2,300,000. PAWC employs approximately 1,000 professionals with expertise in all areas of water and wastewater utility operations. In addition, as a subsidiary of American Water Works Company, Inc., PAWC has available to it the resources of American Water Works Service Company, Inc., which provides access to highly-trained professionals with expertise in specialized areas. When operational issues arise at facilities owned by PAWC, the company mobilizes engineering talent from its central engineering team, drawing on resources from the Service Company, to identify problems, recommend options, and develop action plans. PAWC has an ongoing program of capital investment focused on systematically replacing and adding new pipes and infrastructure. PAWC has funded more than \$1 billion in infrastructure investment in the past five years.

With respect to legal fitness, PAWC has a record of environmental compliance, a commitment to invest in necessary capital improvements and resources, and the experienced managerial and operating personnel necessary to provide safe and reliable sewer service to the

¹⁷ *South Hills Movers, Inc. v. Pa. Pub. Util. Comm'n*, 601 A2d 1308, 1310 (Pa.Cmwlth. 1992). Similarly, PAWC enjoys a presumption of a continuing public need for service because public utility service is already being provided in the service territory. *Re Glenn Yeager et al.*, 49 Pa. PUC 138 (1975). No party has contested the need for wastewater service in the McKeesport area.

residents of the McKeesport area. PAWC has a good compliance history with the Commission and there are currently no legal proceedings that would suggest that PAWC is not legally fit to provide service in the McKeesport area.

With respect to financial fitness, PAWC had total assets of approximately \$4.35 billion as of December 31, 2016. It had a net income of approximately \$153 million for the 12 months ending December 31, 2016. In addition to positive operating cash flows, PAWC has a \$400 million line of credit, long term debt financing, and equity investments.

2. Public Benefits

The Joint Petitioners have agreed that it is appropriate for the Commission to grant PAWC a certificate of public convenience to acquire substantially all of the assets of MACM and to begin to render public utility service to its customers.

PAWC and I&E, in particular, point to a collection of benefits to the various stakeholders to the Transaction which support the Settlement. For example, PAWC observes that the acquisition benefits members of the public-at-large in the following respects:

- The Transaction promotes the Commission's policy favoring regionalization and consolidation of water and wastewater systems.
- The Transaction is beneficial from an environmental perspective because PAWC is in a better position to address environmental deficiencies and operate the System in an environmentally-friendly manner due to its greater expertise and financial resources.
- The Transaction is beneficial from an economic perspective. Spreading fixed costs across a larger asset platform and customer base is positive toward the company's credit and credit ratings, which facilitates borrowing at lower interest rates. Because of its size, expertise and economies of scale, PAWC will be able to improve efficiencies and lower costs that would otherwise be incurred to operate the System and fund necessary improvements.

In I&E's view, the most important benefit is PAWC's commitment to address the MACM system's environmental compliance issues, which is a benefit that extends beyond the MACM service area. I&E agrees with PAWC and MACM, that PAWC's plan to bring the MACM system into environmental compliance operates not just as a benefit to McKeesport, but also to the general public because environmental contamination and pollution caused by the MACM is not confined to the strict boundaries of the service area.

MACM's system had the following compliance issues pending with the Pennsylvania Department of Environmental Protection and/or the Allegheny County Health Department: (1) McKeesport Construction-Related Dry-Weather Overflows; (2) Duquesne Long Term Control Plan (LTCP) (3) Dravosburg LTCP; (4) Dravosburg Mine Discharges; (5) Dravosburg Nine Minimum Controls Plan ("NMCP"); (6) Port Vue LTCP; (7) Port Vue Grade 4 and 5 Defects; and (8) Port Vue NMCP. As an example of the reality of these compliance issues, 53 residential customers in the Dravosburg Borough portion of the MACM service area are not connected to MACM's system and sanitary-only flows from these homes are currently discharged untreated into mine holes. The record also indicates that PAWC has committed to undertaking numerous projects necessary to facilitate environmental compliance measures in the MACM system, and the estimated costs of those projects is \$37,066,723. Accordingly, I&E agrees that PAWC's commitment to bring the MACM system into environmental compliance is an important public benefit which will extend to MACM customers, existing PAWC customers, and to the regulated community.

The Transaction benefits MACM in the same way that it benefits all other members of the public-at-large. In addition, the Transaction has specific benefits for MACM:

- MACM will receive a portion of the purchase price, re-pay a PENNVEST grant, pay off its debt (including a PENNVEST loan), and then be dissolved and terminated.
- MACM voluntarily entered into the Asset Purchase Agreement because it wants to get out of the utility business.

The Transaction benefits the City in the same way that it benefits all other members of the public-at-large. In addition, the Transaction has specific benefits for the City:

- The City will receive a portion of the purchase price, which it will use to promote other public purposes (such as balancing the City's budget, investing in infrastructure improvements, and improving services to City residents). These uses of the proceeds will have a ripple effect on the local economy, enhancing the economic benefits of the Transaction.
- The System will become taxable property.
- City residents who are employees of the System will keep their jobs.

The Transaction benefits MACM's existing customers in the same way that it benefits all other members of the public-at-large. In addition, the Transaction has specific benefits for MACM's existing customers:

- The Transaction will promote rate stability, in part, because PAWC will adopt MACM's base rates existing at the time of closing on the Transaction, will not increase rates until after the first anniversary of the closing date, and is unlikely to include MACM customers in its rates until at least 2020.
- Rates will be lower under PAWC than they would be if the System remained separate and had to deal with its infrastructure and environmental issues on its own.
- The System will become a Commission-regulated utility, and its customers would gain the protection of the Code, the Commission, I&E, OCA, and the Office of Small Business Advocate.
- Customers will have access to PAWC's proven and enhanced customer service, including its customer assistance program (H2O Help to Others) and customer dispute resolution process.

I&E observes MACM customers will benefit from PAWC's additional bill payment options, extended customer service and call center hours, enhanced customer

information and education programs, and access to customer assistance program. Accordingly, the City and existing MACM customers will substantially benefit from this acquisition.

MACM also emphasizes that the Transaction is vitally important to the City. Mayor Cherepko of the City, indicates that the proceeds of the Transaction are crucial to the financial stability of the City. The Transaction would positively impact the City's short-term and long-term financial health, improve MACM's operations and customer service, and provide additional revenue to the City in the form of sale proceeds and tax revenue. Mayor Cherepko indicated that if the Commission would disapprove the Transaction, the City's already difficult financial situation will get worse. In contrast, PAWC has access to equity markets that are unavailable to MACM.

The Joint Petitioners have also agreed to enhanced outreach to MACM's low-income customers. The provisions of the Settlement which provide for outreach to the low-income customers of MACM is favored by OCA. The Mayor of the City of McKeesport testified that in 2015, 38% of McKeesport residents maintained incomes below the poverty level.¹⁸ Paragraph 23 of the proposed Settlement states that, within the first 90 days of its ownership, PAWC will provide information regarding its low-income programs to customers in the McKeesport service area via bill insert or letter, including a description of the available programs, eligibility requirements and PAWC's contact information. In addition, PAWC agrees to conduct ongoing, targeted outreach, in which the OCA will have input.

OCA also supports these provisions because, in OCA's view, these provisions will help to ensure that customers in the McKeesport service area have ongoing information about low-income programs offered by PAWC. This is an important component of the proposed Settlement, particularly, in the context of the Company's commitment to propose increases to the McKeesport rates that move the system toward its cost of service.

I&E also specifically supports Paragraph 23 of the Settlement. Ensuring that low-income customers are aware of available opportunities for financial assistance is in the

¹⁸ PAWC St. 6 at 5.

public interest because these programs will better facilitate these customers' access to wastewater service. Increasing access to wastewater service is consistent with the Public Utility Code's policy to ensure that service remains available to all customers on reasonable terms and conditions.

PAWC explains how the Transaction benefits PAWC's existing wastewater customers in the same way that it benefits all other members of the public-at-large. In addition, the Transaction has specific benefits for PAWC's existing wastewater customers:

- In the short term, the Transaction will have no impact on the rates paid by PAWC's existing customers.
- In the long term, the Transaction will benefit PAWC's existing wastewater customers because it will add a substantial number of new customers to PAWC's wastewater customer base, who can share the cost of operating the entire PAWC wastewater system.
- The Transaction will promote the public policy goals embodied in Section 1329.
- The Transaction will promote the public policy goal of improving and maintaining public infrastructure.

The agreement of the Joint Petitioners regarding PAWC's next base rate case as well as the Settlement provisions mitigate much of the negative rate impacts of the acquisition for PAWC's existing customers. This point was of significant concern to OCA. Discussed in more detail below, these provisions offset potential harm.

I&E also correctly observes the Commission still must consider the benefits of the Transaction as they pertain to PAWC's existing customers. I&E points out that the Transaction will further regionalization of wastewater systems to provide greater environmental and economic benefits to PAWC's customers. Additionally, the acquisition will eventually mitigate the level of net plant investment per customer by adding more customers to share future infrastructure investment costs. PAWC also expects that the acquisition will eventually help PAWC maintain reasonable rates for all its customers in the future because of the expansion of

its customer base. I&E notes that these benefits are substantially similar, if not more numerous, than the public benefits that the Commission sanctioned in the first Section 1329 proceeding.¹⁹ Combining these benefits with the benefit of PAWC's commitment to environmental remediation, which will surely inure to existing ratepayers, and with PAWC's commitment to perform I&E's recommended cost of service study, I&E opines that a benefit to existing ratepayers will be realized.

In sum, the Joint Petitioners have pointed to a number of public benefits to the stakeholders of the Transaction. In their view, these benefits outweigh any negative impacts that may arise from the acquisition. Accordingly, the Joint Petitioners urge the Commission to approve the acquisition as modified by the terms of the Settlement.

B. Section 1329 Approvals

In litigation, the fair market value appraisals and ratemaking rate base were hotly contested issues. While in certain respects the Joint Petitioners have agreed to disagree on certain principles involved in arriving at a ratemaking rate base, the Settlement contains sufficient compromise that the Joint Petitioners now support the acquisition.

1. Ratemaking Rate Base, Fair Market Value and the Appraisals

PAWC supports the amended purchase price for the System to \$159 million, and agreed that only \$158 million will go into PAWC's rate base in its next rate case. In PAWC's view, the proposed Settlement should be adopted because it produces a result that is preferable to what could have resulted from litigation. Moreover, the agreed-upon ratemaking rate base of \$158 million is well within the range of litigation positions of the Joint Petitioners and, accordingly, supported by substantial record evidence.

¹⁹ *Application of Aqua Pennsylvania Wastewater, Inc.*, Docket No. A-2016-2580061 (Opinion and Order entered June 29, 2017), *petition for reconsideration granted July 20, 2017*.

I&E did not oppose PAWC's as-filed proposed ratemaking rate base of \$162 million, because fair market value was predicated upon PAWC's purchase price for the MACM system and not upon the average of the UVEs' appraisals. However, I&E was concerned that that MACM's fair market value appraisal performed by HRG was fundamentally flawed in several ways. Even though PAWC's proposed ratemaking rate base of \$162 million was premised on a negotiated purchase price, I&E noted that those negotiations were premised upon incorrect information. More specifically, as this proceeding developed, HRG witness Vicari acknowledged an error in the calculation of the service life of many of MACM's mains, resulting in a need to increase the service life from 50 to 85 years. The impact of her adjustment was substantial, as this correction led HRG to reduce its net depreciated original cost, which in turn lowered its appraised value of the MACM assets from \$207,010,000 to \$190,000,000. This correction and corresponding reduction in fair market value was not known to PAWC, MACM, or the City when these parties negotiated a purchase price for the MACM assets. For this reason, I&E avers that the Settlement is in the public interest because the ratemaking rate base value has decreased from \$162 million to \$158 million, mitigating any potential impact that the error in HRG's fair market value may have had on the parties' negotiations. Attempting to mitigate the potential impact that any errors in the fair market valuation may have had upon the purchase price in this case is in the public interest because once established in this case, the ratemaking rate base determination will have real and measurable consequences for ratepayers.

OCA objected to the \$162 million ratemaking fair market value requested in the original application. This objection was based on OCA's challenge to the appraisals. In OCA's view, its expert testimony identified numerous errors and the use of assumptions and adjustments that were inconsistent with financial and utility ratemaking practices.²⁰ The OCA's recommended adjustments served to reduce the ratemaking rate base amount below the \$162 million purchase price. Specifically, OCA objected to specific assumptions made by the utility valuation experts which resulted in adjustments that were unreasonable or inconsistent with financial and utility ratemaking practices. OCA's witnesses recommended corrective adjustments.

²⁰ See OCA St. 1 at 18-26; OCA St. 1R at 1-11; OCA St. 1S at 16-20; OCA St. 2 at 4-28; OCA St. 2S at 1-6.

OCA and I&E support Paragraph 15 of the Settlement because it reflects the Joint Petitioner's explicit acceptance of four of the OCA's adjustments. These four are:

- (a) Market Approach: The purchase price for each acquisition shall be based on the actual amount paid for the assets at the time of purchase and future capital improvements shall not be included;
- (b) Income Approach: The rate base / rate of return methodology is not an appropriate analysis for the appraisal;
- (c) The "Going Value" and "Provision for Erosion on Return" add-ons will not be adopted or included in the appraisals; and,
- (d) The overhead cost add-on will not be adopted or included in the appraisals.

In OCA's view, these adjustments reflect accepted financial and utility ratemaking principles and help to improve the reliability of data used in appraisals and the integrity of the result. I&E agrees. I&E notes that there is nothing in Section 1329 that contemplates a going value adjustment or premium. Accordingly, eliminating these adjustments is in the public interest because it protects ratepayers from bearing the costs of an artificially inflated rate base, thereby preserving the Commission's ability to ensure that rates are just and reasonable for PAWC's customers.

In settlement, the parties agreed that for ratemaking purposes, the ratemaking rate base pursuant to Section 1329 will be \$158 million. The proposed ratemaking rate base pursuant to Section 1329 is lower than requested in the Applicant's filing and represents an amount which, in OCA's view, would be within the range of likely outcomes in the event of full litigation of the case. This provides some mitigation of the rate impact of the Transaction for existing PAWC customers and the acquired McKeesport customers by reducing overall costs. Additionally, I&E and OCA support the Settlement because of the agreed adjustments to the appraisals. Therefore, OCA supports the adjusted ratemaking fair market value.

2. Rates

In terms of rates, PAWC contends that the Settlement is in the public interest because it would not only ensure that PAWC will charge rates after closing that are equal to MACM's existing rates, it includes certain commitments by PAWC about the rates it will propose in its next two base rate cases.

To ensure that their rates do not increase significantly due to the Transaction, the Settlement includes commitments by PAWC regarding its rate proposals in its next two base rate cases. These proposals are intended to ensure that McKeesport area customers at least pay the same rates as PAWC's Zone 1 ratepayers (or higher rates, if the Zone 1 rates are less than the costs of service for the McKeesport service territory). These commitments provide reasonable protection for PAWC's existing wastewater customers, which probably would not have resulted from a fully litigated proceeding.

PAWC also notes that the Settlement explicitly recognizes the ability of PAWC and other parties to the rate cases to settle those cases on reasonable terms and conditions. Moreover, the Settlement explicitly recognizes that the Commission retains ultimate ratemaking authority to set just and reasonable rates because of those future base rate cases. The Settlement's rate commitments reflect a recognition by the Joint Petitioners that the McKeesport rates must move in a reasonable and timely manner toward the true cost of service for McKeesport-area customers, including payment by those customers for the stormwater-related costs of the combined wastewater service.

The Settlement also requires PAWC to perform certain cost of service studies in connection with future base rate cases. PAWC originally objected to the cost of service studies requested by I&E in litigation largely due to the expense. PAWC acknowledges that the acquisition will generate novel ratemaking issues that have yet to be resolved by the Commission in the context of a base rate proceeding (including revenue allocation associated with a Section 1329 acquisition and treatment of the stormwater-related costs of combined wastewater service). Under the Settlement, PAWC's obligation to prepare cost of service studies extends only to its

next base rate case. In this way, unnecessary cost of service studies can be avoided in subsequent rate cases if the novel ratemaking issues are resolved by the Commission in such a way that separate cost of service studies are not required.

PAWC emphasizes that these commitments would not have been achieved if the case had been litigated to conclusion.

MACM also supports the rate provisions. MACM observes the Settlement provides that PAWC will propose gradual rate increases for System customers (while acknowledging that the Commission has ultimate authority to set rates). As explained in Paragraphs 20 and 22 of the Settlement, PAWC has committed to propose to increase rates for System customers in a gradual manner over the course of PAWC's next one to two base rate cases to bring such rates in line with PAWC's system average rates (Rate Zone 1) over that time period. These Settlement provisions are consistent with the Commission's policies of rate gradualism and single tariff pricing.

I&E explains that requiring PAWC to provide this cost of service study would ensure that in a future rate case, the Commission is provided with a tool to determine the cost to operate the MACM system separately and to calculate the costs of the MACM's different services. Additionally, the cost of service study will preserve future ratemaking options by separating the costs between PAWC's different customer classes and jurisdictions, attributing costs to PAWC's different customer classes and jurisdictions, and, importantly, enabling the determination of how costs will be recovered from the utility's different customer classes and jurisdictions.

I&E also points out that cost of service studies are important to avoid cross-subsidization. Here, subsidization is likely to be an issue in PAWC's next rate case, as PAWC witness Nevirauskas indicated that PAWC has access to Act 11 under which it "may allocate a portion of the wastewater requirement to the combined water and wastewater customer base if in the public interest." PAWC witness Nevirauskas further concluded that in PAWC's next base rate case, PAWC may spread a portion of the costs associated with the MACM system to its

water customers. Absent the cost of service study, the Commission's ability to evaluate any cost spreading from the perspective of cost causation would be compromised. Accordingly, PAWC's agreement to perform the cost of service studies as set forth in Paragraphs 17-21 of the Settlement are an important compromise.

I&E emphasizes the fact that MACM's status as a combined sewer over flow system (CSO) highlights the importance of the cost of service term. A system's classification as a CSO means that its ratepayers have additional costs built into their rates that traditional sanitary sewer customers do not. Examples of these additional costs include capital plant costs for storm water catch basins, storm sewer mains prior to the combination with sanitary sewers, and overflows for when the volumes exceed the capacity of the treatment facility. Further related costs include maintenance expenses for cleaning the catch basins, repairing mains, and additional chemical expenses for the higher volumes that are treated during storm events. Without having a cost of service study that identifies and separates these costs, there will be no way for the Commission to properly review and, as appropriate, assign these costs in PAWC's next base rate case.

OCA identified specific harm to PAWC's existing customers and to the acquired McKeesport customers that would result from the acquisition. In particular, OCA pointed out that the acquisition could increase rates for PAWC's existing wastewater customers and water customers if the costs of the MACM system are added to rate base and shifted to those customers. OCA noted that if MACM customers' rates were raised to cover the cost of service under the agreed upon purchase price and PAWC ownership, those customers would see an increase of approximately 137% from current rates, in the first rate case that takes effect after the one-year rate freeze contained in the Asset Purchase Agreement.

OCA supports the settlement terms related to rates and points out that the Settlement seeks to address OCA's concerns in several ways. First, Paragraphs 17 and 18 require PAWC to provide a cost of service study that fully separates the costs of providing the stormwater component of wastewater services in the McKeesport service area and a study that identifies all costs and revenues associated with the operations (sanitary and stormwater) of the

McKeesport system. This provision helps to analyze the exact cost of the acquired system including its separate stormwater component.

Second, Paragraph 11 provides that, in its first base rate case following closing, PAWC will propose to establish a separate rate zone for McKeesport, which will provide a means for the parties to use the cost of service data to set rates for those customers that differ, as appropriate, from rates established for other wastewater customers.

Third, Paragraph 11 also provides that, in the first base rate case after the acquisition closes, PAWC will propose to increase the rates for the McKeesport system to an amount equal to the Zone 1 wastewater rates of PAWC's wastewater division, unless such increase would be more than 2.0x the system-average wastewater division increase. This settlement term helps to address the potential level of subsidy by PAWC's other wastewater customers (and potentially its water customers) and applies the ratemaking principle of gradualism to rates set for customers in the McKeesport service area.

Fourth, Paragraphs 11 and 12 move the acquired customers toward their cost of service. While Paragraph 11 moves the acquired customers to or toward Zone 1 wastewater rates, Paragraph 12 moves them further toward a rate level that reflects their full cost of service. Specifically, it provides that, in PAWC's second base rate case following closing, PAWC will propose to increase the rates of the McKeesport system to an amount at least equal to Zone 1 and further toward the system's cost of service. These provisions help to mitigate any cross-subsidization.

3. DSIC

Section 1329(d) of the Code permits an acquiring public utility to collect a DSIC from the date of closing on the Transaction until new rates are approved in the utility's next base rate case. To qualify for DSIC recovery, a utility must submit a long-term infrastructure investment plan (LTIP) to, and receive approval from, the Commission.

PAWC notes that it has previously received Commission approval of a wastewater LTIIIP plan, and received Commission approval of a DSIC tariff, for other portions of its wastewater system. In its application, PAWC requested conditional approval to implement a DSIC for the McKeesport service territory. PAWC proposed to file an amended LTIIIP for the McKeesport service territory. Following Commission approval of that amended LTIIIP, PAWC would make a tariff supplement compliance filing, which would include the McKeesport service territory in PAWC's existing DSIC tariff.

OCA and I&E support the Settlement because it includes conditions to ensure that PAWC's amended LTIIIP will not re-prioritize existing commitments in other service areas. In addition, the Settlement recognizes the Commission's authority to modify PAWC's LTIIIP submission. While I&E still reserves its rights, I&E nevertheless opines that this term serves the public interest because PAWC has agreed that existing commitments will not be re-prioritized because of this term. With this in mind, the System customers will benefit from improved wastewater infrastructure, promoting safer and more reliable service. At the same time, the improvements already identified and planned for existing PAWC ratepayers will not be jeopardized by PAWC's commitment to MACM. Therefore, I&E takes the position that this term is in the public interest.

4. Allowance for Funds Used During Construction

Section 1329(f)(1) of the Code permits an acquiring public utility to accrue an allowance for funds used during construction (AFUDC) on post-acquisition improvements that are not included in a DSIC, from the date the cost was incurred until the earlier of the following events: the asset has been in service for a period of four years, or the asset is included in the acquiring utility's next base rate case. In the application, PAWC simply requested permission to accrue AFUDC on post-acquisition improvements that are not included in a DSIC. PAWC takes the position that the Settlement is in the public interest because it makes clear that the other Joint Petitioners do not oppose this request but they reserve their rights to litigate their positions fully in future rate cases.

I&E endorses this term because while it enables PAWC to memorialize its intent to employ certain provisions of Section 1329, it also empowers parties to review PAWC's proposal in a future base rate case. Preserving the ability to litigate the proposed AFUDC treatment protects the public interest by ensuring that interested parties are not hindered in developing a full and complete record for the Commission on this issue when additional information is available and ratemaking issues are ripe for determination.

5. Deferred Depreciation

Similarly, Section 1329(f)(2) of the Code permits an acquiring public utility to defer depreciation on its post-acquisition improvements that are not included in a DSIC. In the Application, PAWC simply requested permission to defer depreciation on post-acquisition improvements that are not included in a DSIC. The Joint Petitioners believe the Settlement is in the public interest because it makes clear that the other Joint Petitioners do not oppose this request and they reserve their rights to litigate their positions fully in future rate cases.

6. Transaction and Closing Costs

Section 1329(d)(1)(iv) permits an acquiring public utility to include, in its next base rate case, a claim for the Transaction and closing costs incurred for the acquisition. In *Implementation of Section 1329 of the Public Utility Code*, Docket No. M-2016-2543193 (Order entered October 27, 2016) p. 14, the Commission stated that there will be no Commission preapproval of the reasonableness of recovery of these costs in a Section 1329 proceeding. Out of an abundance of caution, the application requested permission to include, in PAWC's next base rate case filed after its currently-pending base rate proceeding, the Transaction and closing costs incurred in this proceeding. The Commission will adjudicate the ratemaking treatment of PAWC's claimed transaction and closing costs at that time. Like the agreement of the Joint Petitioners related in AFUDC and deferred depreciation, the Joint Petitioners aver the Settlement is in the public interest because it makes clear that the other Joint Petitioners do not oppose this request and they reserve their rights to litigate their positions fully in future rate cases.

C. Recommendation

Viewed in totality, the Settlement represents a fair compromise of competing views and interests and should be approved without modification. The modifications to the Transaction permitting the acquisition of MACM by PAWC, as agreed upon in the Settlement contains provisions which adequately protect the competing interests of PAWC's existing customers and stockholders, the customers of MACM and the general public. The agreed upon ratemaking rate base value is within the range of proposals made by the parties during the litigation and is consistent with the mandates of Section 1329. Importantly, the rate treatment of MACM and its customers and existing PAWC customers as well as the cost of service studies are critical to protecting PAWC's existing customers from potential cross-subsidization or other negative rate impacts.

We agree with PAWC's observation that the Joint Petitioners, and their counsel and experts, have considerable experience in acquisition proceedings.²¹ Their knowledge, experience and ability to evaluate the strengths and weaknesses of their litigation positions provided a strong base upon which to build a consensus on all the issues. The Joint Petitioners, their counsel and experts fully explored all the issues in this case. The Joint Petitioners negotiated the Settlement in consideration of an uncertain legal landscape. They recognized that, absent settlement, this case could have become mired in appellate litigation; and the public benefits of the acquisition potentially would not have been realized for years -- if at all. The Settlement reflects a carefully balanced compromise of the interests of the Joint Petitioners and satisfies the various requirements of the Code. For these reasons, and the reasons discussed above, the Settlement is in the public interest and should be approved without modification.

V. CONCLUSIONS OF LAW

1. The Commission has jurisdiction over the subject matter of, and the parties to, this application proceeding. 66 Pa.C.S. §§ 1102, 1103, 1329.

²¹ Indeed, the parties are to be commended on the quality and organization of both the briefing and statements in support which were submitted in this case.

2. Pennsylvania-American Water Company has the burden of proof in this proceeding. 66 Pa.C.S § 332(a).

3. Commission policy promotes settlement. *See* 52 Pa.Code § 5.231.

4. A settlement lessens the time and expense that the parties must expend litigating a case and, at the same time, conserves precious administrative resources. The Commission has indicated that settlement results are often preferable to those achieved at the conclusion of a fully-litigated proceeding. *See* 52 Pa.Code § 69.401.

5. In order to accept a settlement, the Commission must determine that the proposed terms and conditions are in the public interest. *Pa. Pub. Util. Comm'n v. York Water Co.*, Docket No. R-00049165 (Order entered Oct. 4, 2004); *Pa. Pub. Util. Comm'n v. C.S. Water and Sewer Assocs.*, 74 Pa. PUC 767 (1991).

6. The Settlement and its proposed terms and conditions are in the public interest and, therefore, should be approved without modification.

7. The Commission may issue a certificate of public convenience upon a finding that “the granting of such certificate is necessary or proper for the service, accommodation, convenience, or safety of the public.” 66 Pa.C.S. § 1103(a) (“Procedure to obtain certificates of public convenience”).

8. A certificate of public convenience is required for “any public utility to begin to offer, render, furnish or supply within this Commonwealth service of a different nature or to a different territory than that authorized” 66 Pa.C.S. § 1102(a)(1).

9. A certificate of public convenience is required for “any public utility . . . to acquire from . . . any person or corporation, including a municipal corporation, by any method or device whatsoever . . . the title to, or possession or use of, any tangible or intangible property used or useful in the public service.” 66 Pa.C.S. § 1102(a)(3).

10. An applicant for a certificate of public convenience must demonstrate that it is technically, financially, and legally fit to own and operate the acquired public utility assets. *Seaboard Tank Lines v. Pa. Pub. Util. Comm'n*, 502 A.2d 762, 764 (Pa.Cmwlth. 1985); *Warminster Township Mun. Auth. V. Pa. Pub. Util. Comm'n*, 138 A.2d 240, 243 (Pa.Super. 1958).

11. The fitness of a currently certificated public utility is presumed. *See e.g., South Hills Movers, Inc. v. Pa. Pub. Util. Comm'n*, 601 A.2d 1308, 1310 (Pa.Cmwlth. 1992).

12. An applicant for a certificate of public convenience must demonstrate that the transaction will “affirmatively promote the service, accommodation, convenience or safety of the public in some substantial way.” *City of York v. Pa. Pub. Util. Comm'n*, 449 Pa. 136, 151, 295 A.2d 825, 828 (1972).

13. In granting a certificate of public convenience, the Commission may impose such conditions as it may deem to be just and reasonable. 66 Pa.C.S. § 1103(a).

14. For an acquisition in which a municipal authority and the acquiring public utility agree to use the valuation procedure delineated in 66 Pa.C.S. § 1329, the ratemaking rate base of the selling utility shall be the lesser of the purchase price negotiated by the parties or the fair market value of the selling utility. 66 Pa.C.S. § 1329(c)(2).

15. “Fair market value” is defined as “the average of the two utility valuation expert appraisals conducted under subsection (a)(2).” 66 Pa.C.S. § 1329(g).

16. For an acquisition in which a municipal authority and the acquiring public utility agree to use the valuation procedure delineated in 66 Pa.C.S. § 1329, the application is to contain a tariff equal to the existing rates of the selling utility at the time of the acquisition and a rate stabilization plan, if applicable to the acquisition. 66 Pa.C.S. § 1329(d)(1)(v).

17. During the period that the *pro forma* tariff supplement is in effect, an acquiring public utility may collect a distribution system improvement charge, as approved by the Commission. 66 Pa.C.S. § 1329(d)(4).

18. A wastewater utility must submit a long-term infrastructure improvement plan to, and receive approval from, the Commission prior to collecting a distribution system improvement charge. *Implementation of Act 11 of 2012*, Docket No. M-2012-2293611 (Final Implementation Order entered August 2, 2012).

19. Pennsylvania-American Water Company must submit an amended long term infrastructure improvement plan, and receive Commission approval, before including the McKeesport service territory in its DSIC. 66 Pa.C.S. §§ 1352-1353, 52 Pa. Code §§ 121.3-121.4.

20. Pennsylvania-American Water Company's distribution system improvement charge tariff has been approved by the Commission. *Petition of Pennsylvania-American Water Company Wastewater Operations for Approval of Long Term Infrastructure Improvement Plan and Approval to Establish and Implement a Distribution System Improvement Charge*, Docket Nos. P-2014-2431005, *et al.* (Order entered May 7, 2015).

21. Section 1329 permits an acquiring public utility's post-acquisition improvements, which are not included in a DSIC, to accrue allowance for funds used during construction after the date the cost was incurred until the asset has been in service for a period of four years or until the asset is included in the acquiring public utility's next base rate case, whichever is earlier. 66 Pa.C.S. § 1329(f)(1).

22. Section 1329 permits an acquiring public utility to defer depreciation on post-acquisition improvements, which are not included in a DSIC. 66 Pa.C.S. § 1329(f)(2).

23. Section 1329 permits an acquiring public utility to include transaction and closing costs in its rate base, during its next base rate proceeding. 66 Pa.C.S. § 1329(d)(2). The

Commission will not approve these costs during the 1329 proceeding. *Implementation of Section 1329 of the Public Utility Code*, Docket No. M-2016-2543193 (Final Implementation Order entered October 27, 2016).

24. A contract between a municipality and a public utility (other than a contract to furnish service at regular tariff rates) must be filed with the Commission at least 30 days before the effective date of the contract. The Commission may approve it by issuing a certificate of filing or institute proceedings to determine whether there are any issues with the reasonableness, legality, or any other matter affecting the validity of the contract. 66 Pa.C.S. § 507.

VI. ORDER

THEREFORE,

IT IS RECOMMENDED:

1. That the Joint Petition for Approval of Settlement of All Issues, filed by Pennsylvania-American Water Company, the City of McKeesport, the Municipal Authority of the City of McKeesport, the Office of Consumer Advocate, and the Pennsylvania Public Utility Commission's Bureau of Investigation and Enforcement on September 20, 2017 at Docket No. A-2017-2606103, including all terms and conditions thereof, is approved without modification.

2. That the Application filed by Pennsylvania-American Water Company on May 24, 2017 is granted, subject to the following conditions, which are consistent with the Joint Petition for Approval of Settlement of All Issues:

(a) That Pennsylvania-American Water Company file a further amendment to the Asset Purchase Agreement, along with copies of required authorizations from

Pennsylvania-American Water Company's Board of Directors, the City's Council, and MACM's Board of Directors, that (a) adjusts the purchase price to \$159,000,000 and (b) modifies Paragraph F of the First Amendment to the Asset Purchase Agreement (regarding Pennsylvania-American Water Company's obligation in the first base rate case following closing of the transaction to propose rates that, if adopted by the Commission, would ensure that McKeesport-system customers benefit from 66 Pa. C.S. § 1311(c) in the same manner as Pennsylvania-American Water Company's other customers) such that Pennsylvania-American Water Company will seek to utilize 66 Pa.C.S. § 1311(c) for the benefit of McKeesport system customers so long as such use is not inconsistent with Pennsylvania-American Water Company's obligations under the Commission's Order.

(b) That, at the time of filing its next base rate case, Pennsylvania-American Water Company shall submit a cost of service study that fully separates the costs of providing the stormwater component of wastewater services in the McKeesport service area.

(c) That, at the time of filing its next base rate case, Pennsylvania-American Water Company shall submit a cost of service study that removes all costs and revenues associated with the operations (both the sanitary component and stormwater component) of the wastewater service of the MACM system and using the same rate design methodology it proposes to be adopted in that case, develop rates in its next base rate case that exclude the impact of the MACM system acquisition.

(d) That the plant in service costs of the Port Vue Borough component of the system shall be identified separately in the required cost of service studies. Pennsylvania-American Water Company shall separately identify the plant-in-service costs at the time that the Port Vue system was purchased, the cost of any Port Vue plant retirements, and the cost of any Port Vue plant investment.

3. That the Secretary's Bureau shall issue Certificates of Public Convenience under 66 Pa.C.S. §§ 1102(a) and 1103(a) authorizing: (a) the transfer, by sale, of substantially all of MACM's assets, properties and rights related to its wastewater collection and treatment

system to Pennsylvania-American Water Company; and (b) Pennsylvania-American Water Company's right to begin to offer, render, furnish and supply wastewater service in the areas served by MACM in the City of McKeesport, the City of Duquesne, Port Vue Borough, and the Borough of Dravosburg, and a portion of West Mifflin Borough, Allegheny County, Pennsylvania and to three bulk service interconnection points located in Liberty Borough, White Oak Borough, and North Versailles Borough, Allegheny County, Pennsylvania.

4. That within 10 days after the closing of the Transaction, Pennsylvania-American Water Company shall issue a compliance tariff supplement, consistent with the *pro forma* tariff supplement attached to the Joint Petition for Approval of Settlement of All Issues at Appendix A and containing the existing rates of the Municipal Authority of the City of McKeesport at the time of the closing, to be effective on the date of issuance.

5. That pursuant to 66 Pa.C.S. § 1329(c), the Commission approves a rate base addition of \$158,000,000 associated with Pennsylvania-American Water Company's acquisition of the MACM system.

6. That within the first 90 days of Pennsylvania-American Water Company's ownership of the System, Pennsylvania-American Water Company shall include a bill insert to McKeesport-area customers regarding its low-income programs or alternatively shall include such information in a welcome letter to McKeesport-area customers. The bill insert or welcome letter shall include, at a minimum, a description of the available low-income programs, the eligibility requirements for participation in the programs, and Pennsylvania-American Water Company's contact information. Pennsylvania-American Water Company also agrees to ongoing, targeted outreach to its McKeesport-area customers regarding its low income program. The Joint Petitioners shall confer in good faith and agree upon such additional outreach prior to closing of the Transaction.

7. That Pennsylvania-American Water Company may collect a distribution system improvement charge related to the MACM system prior to the first base rate case in

which the System plant-in-service is incorporated into Pennsylvania-American Water Company's rate base, subject to the following conditions:

(a) Pennsylvania-American Water Company files an amended wastewater long term infrastructure investment plan incorporating the McKeesport area, which does not re-prioritize other existing commitments in other service areas;

(b) The Commission approves the amended wastewater long term infrastructure investment plan incorporating the McKeesport area, as may be modified in the discretion of the Commission; and

(c) Pennsylvania-American Water Company files a compliance tariff supplement filing incorporating the McKeesport service territory into Pennsylvania-American Water Company's existing wastewater DSIC tariff provisions.

8. That Pennsylvania-American Water Company may accrue an allowance for funds used during construction for post-acquisition improvements not recovered through the DSIC for book and ratemaking purposes.

9. That Pennsylvania-American Water Company may defer depreciation related to post-acquisition improvements not recovered through the DSIC for book and ratemaking purposes.

10. That Pennsylvania-American Water Company may include, in its next base rate case, a claim for transaction and closing costs related to the acquisition of the MACM system.

11. That the Secretary's Bureau shall issue Certificates of Filing pursuant to Section 507 for the following agreements between Pennsylvania-American Water Company and a municipal corporation:

(a) Asset Purchase Agreement By and Among the City of McKeesport, The Municipal Authority of the City of McKeesport, as Seller, and Pennsylvania-American Water Company, as Buyer, Dated as of September 9, 2016, as amended by First Amendment to the Asset Purchase Agreement, Dated as of May 15, 2017, along with related City of McKeesport General Obligation Note, Series of 2016, No. R-1, related Intercept Agreement, Dated November 30, 2016, and related Second Deposit Note, which is yet to be executed, and as further amended by the amendment specified in Paragraph 14 of the Settlement;

(b) Service Agreement By and Among The Municipal Authority of the City of McKeesport and Liberty Borough, Dated as of July 28, 2010;

(c) Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and Liberty Borough, Dated as of July 28, 2008;

(d) Service Agreement By and Among The Municipal Authority of the City of McKeesport and Lincoln Borough, Dated as of September 15, 2009;

(e) Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and Lincoln Borough, Dated as of September 15, 2009;

(f) Service Agreement By and Among The Municipal Authority of the City of McKeesport and Elizabeth Township, Dated as of October 14, 2008;

(g) Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and Elizabeth Township, Dated as of October 14, 2008;

(h) Service Agreement By and Among The Municipal Authority of the City of McKeesport and The Municipal Authority of Westmoreland County for White Oak Borough, Dated as of August 2009;

(i) Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and The Municipal Authority of Westmoreland County for White Oak Borough, Dated as of August 2009;

(j) Service Agreement By and Among The Municipal Authority of the City of McKeesport, North Versailles Township, and The North Versailles Township Sanitary Authority, Dated as of October 1, 2008;

(k) Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport, North Versailles Township, and The North Versailles Township Sanitary Authority, Dated as of August 21, 2008;

(l) Service Agreement By and Among The Municipal Authority of the City of McKeesport and East McKeesport Borough, Dated as of September 11, 2008;

(m) Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and East McKeesport Borough, Dated as of August 2008;

(n) Service Agreement By and Among The Municipal Authority of the City of McKeesport and Versailles Borough, Dated as of October 22, 2008;

(o) Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and Versailles Borough, Dated as of October 22, 2008;

(p) Service Agreement By and Among The Municipal Authority of the City of McKeesport and Glassport Borough, Dated as of August 19, 2008; and,

(q) Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and Glassport Borough, Dated as of August 19, 2008.

